Accounting in Business

Chapter 1

Wild and Shaw

Fundamental Accounting Principles

25th Edition

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Chapter 1 Learning Objectives

CONCEPTUAL

C1 Explain the importance of accounting and identify its users.

C2 Describe the importance of ethics and GAAP.

ANALYTICAL

A1 Define and interpret the accounting equation and each of its components.

A2 Compute and interpret return on assets.

PROCEDURAL

P1 Analyze business transactions using the accounting equation.

P2 Identify and prepare basic financial statements and explain how they interrelate.

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Learning Objective C1

Explain the importance of accounting and identify its users.

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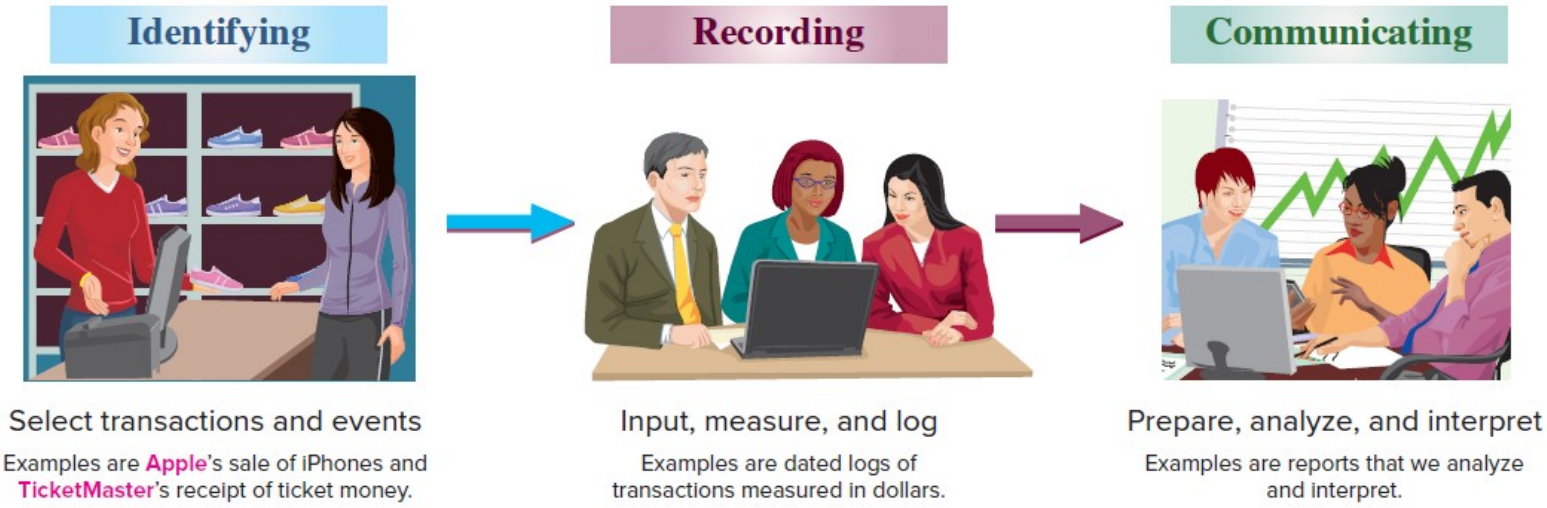
Importance of Accounting

Exhibit 1.1


Identifying
Recording
Communicating
Select transactions and events
Examples are Apple's sale of iPhones and TicketMaster's receipt of ticket money.
Input, measure, and log
Examples are dated logs of transactions measured in dollars.
Prepare, analyze, and interpret
Examples are reports that we analyze and interpret.

Accounting is an information and measurement system that identifies, records, and communicates an organization's business activities.

Learning Objective C1: Explain the importance of accounting and identify its users.

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Users of Accounting Information

Accounting is called the *language of business* because it communicates data to help people make better decisions. People using accounting information are divided into two groups: external users and internal users.

External users

- Shareholders
- Lenders
- External auditors
- Nonmanagerial employees
- Regulators

Internal users

- Purchasing managers
- Human resource managers
- Production managers
- Research and development managers
- Marketing managers

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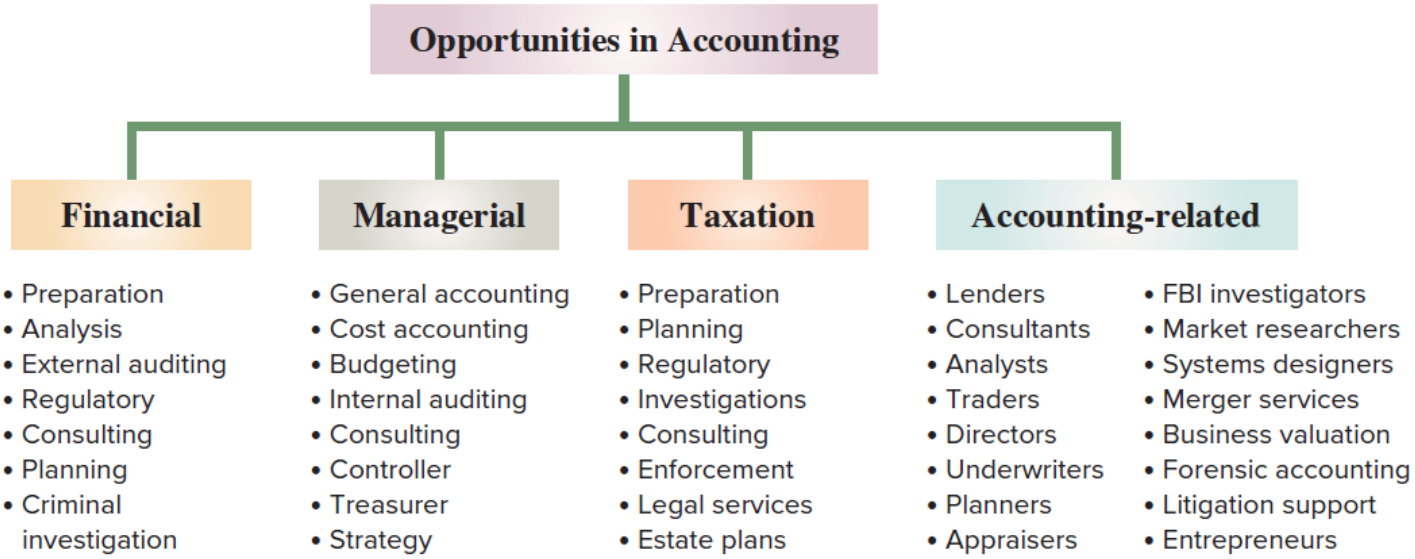
Opportunities in Accounting

Exhibit 1.2



The majority of opportunities are in private accounting, where employees work for a business. Public accounting includes auditing, taxation, and advisory services.

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Artificial Intelligence and Data Analytics

- Artificial Intelligence (AI) uses software and can be used to complete repetitive tasks such as entering invoices and transaction data.
- Accountants are needed to help develop advanced AI systems and analyze reports and graphics.
- Data analytics is a process of analyzing data to identify meaningful relations and trends.
- Data visualization is a graphical presentation of data to help individuals make informed business decisions.

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Learning Objective C2

Describe the importance of ethics and GAAP.

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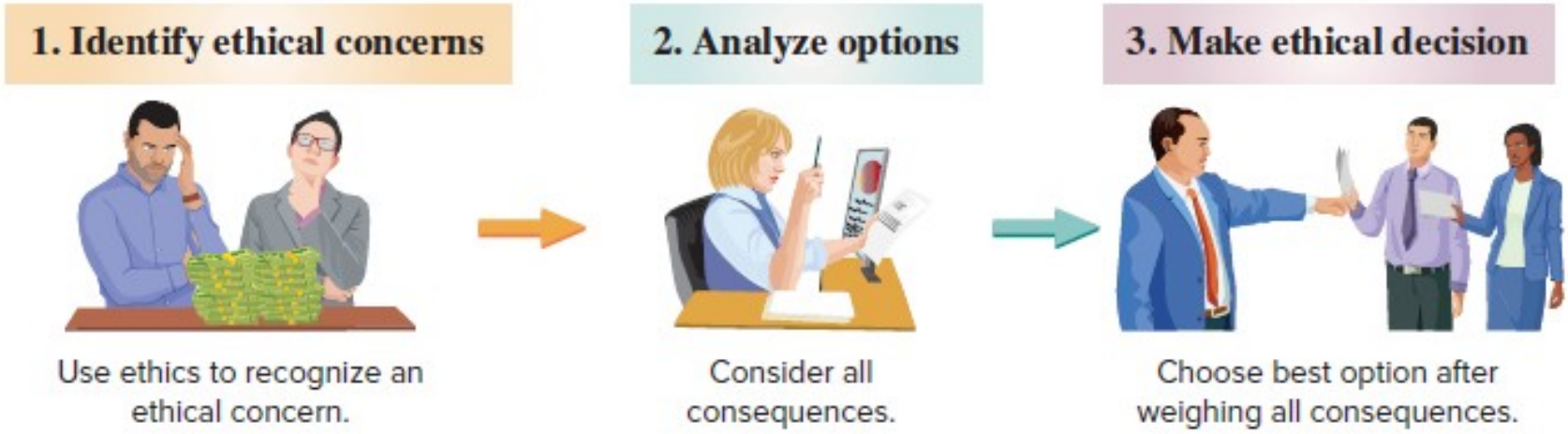
Ethics – A Key Concept

Exhibit 1.5

The goal of accounting is to provide useful information for decisions. For information to be useful, it must be trusted. This demands ethics in accounting. Ethics are beliefs that distinguish right from wrong. They are accepted standards of good and bad behavior.


1. Identify ethical concerns
2. Analyze options
3. Make ethical decision
Use ethics to recognize an ethical concern.
Consider all consequences.
Choose best option after weighing all consequences.

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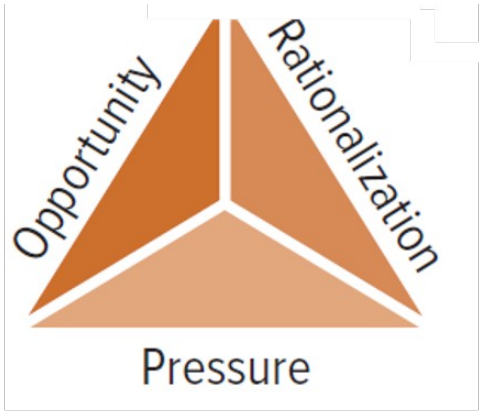
Fraud Triangle

Three factors must exist for a person to commit fraud: opportunity, pressure, and rationalization.

Envisions a way to commit fraud with low risk of getting caught



Fails to see the criminal nature of the fraud or justifies the action

Must have some pressure to commit fraud, like unpaid bills

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Generally Accepted Accounting Principles (GAAP)

Financial accounting is governed by concepts and rules known as **generally accepted accounting principles (GAAP).** GAAP wants information to have *relevance* and *faithful representation*.

Relevant information affects decisions of users.

Faithful representation means information accurately reflects business results.

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Financial Accounting Standards Board (FASB)

- **The FASB sets GAAP.**
- **Authority provided by the Securities and Exchange Commission (SEC).**
- **The SEC is a U.S. government agency that oversees GAAP by companies that sell stock and debt to the public.**

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International Standards

In today's global economy, there is increased demand by external users for comparability in accounting reports.

International Accounting Standards Board (IASB)

- Issues International Financial Reporting Standards (IFRS).
- Standards identify preferred accounting practices.
- Standards are similar to, but sometimes different from U.S. GAAP.
- FASB and IASB are working to reduce differences.

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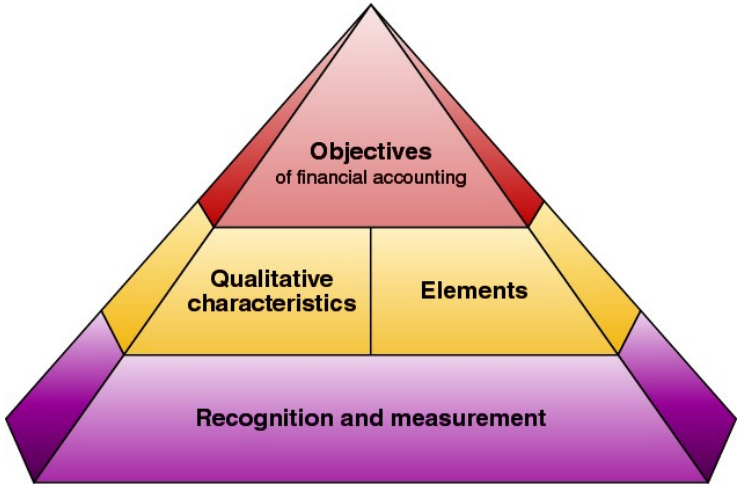
Conceptual Framework

Exhibit 1.6

- **Objectives** – provide useful information to investors, creditors, and others.
- **Qualitative characteristics** – information has relevance and faithful representation.
- **Elements** – defines items in financial statements.
- **Recognition and measurement** – criteria for an item to be recognized as an element and how to measure it.



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Principles, Assumptions and Constraint

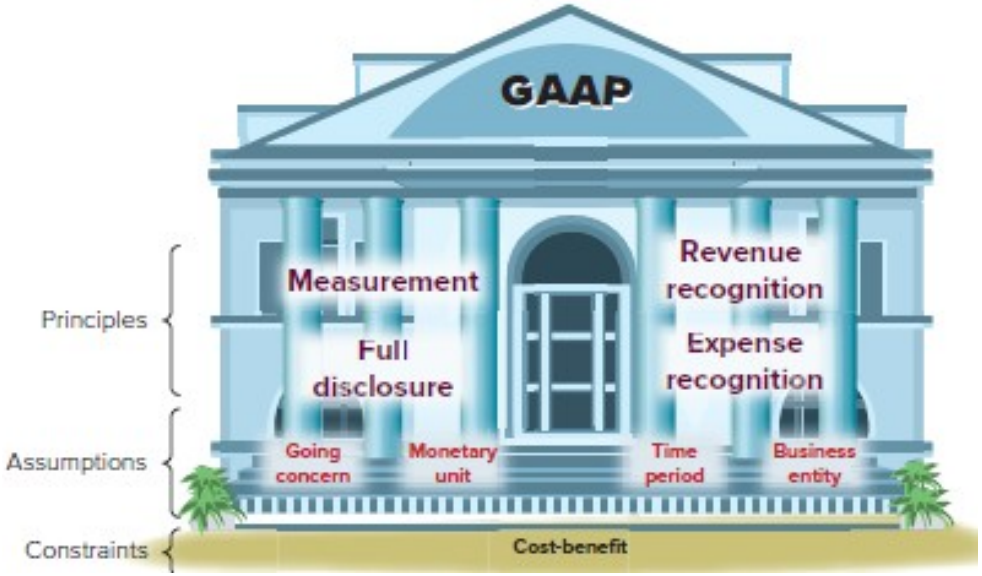

Exhibit 1.7

General principles are the assumptions, concepts, and guidelines for preparing financial statements.

Specific principles are detailed rules used in reporting business transactions and events.

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Accounting Principles

Measurement Principle (Cost Principle)

Accounting information is based on actual cost. Actual cost is considered objective.

Revenue Recognition Principle

1. Recognize revenue when goods or services are provided to customers and
2. at an amount expected to be received from the

Expense Recognition Principle (Matching Principle)

A company records its expenses incurred to generate the revenue reported.

Expense Recognition Principle (Matching Principle)

A company records its expenses incurred to generate the revenue reported.

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Accounting Assumptions

Going-Concern Assumption

The business is presumed to continue operating instead of being closed or sold.

Monetary Unit Assumption

Transactions and events are expressed in monetary, or money, units.

Time Period Assumption

The life of a company can be divided into time periods, such as months and years.

Business Entity Assumption

A business is accounted for separately from other business entities, including its owner.

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Proprietorship, Partnership, and Corporation

Exhibit 1.8

Here are some of the major attributes of sole proprietorships, partnerships, corporations, and

	Sole Proprietorship	Partnership	Corporation	Limited Liability Company (LLC)
Number of owners	1 owner; easy to set up.	2 or more, called *partners;* easy to set up.	1 or more, called *shareholders;* can get many investors by selling **stock** or **shares** of corporate ownership.*	1 or more, called *members.*
Business taxation	No additional business income tax.	No additional business income tax.	Additional corporate income tax.	No additional business income tax.
Owner liability	Unlimited liability. Owner is personally liable for **proprietorship** debts.	Unlimited liability. Partners are jointly liable for partnership debts.	Limited liability. Owners, called **shareholders** (or **stockholders**), are not liable for corporate acts and debts.	Limited liability. Owners, called **members,** are not personally liable for LLC debts.
Legal entity	*Not* a separate legal entity.	*Not* a separate legal entity.	A separate entity with the same rights and responsibilities as a person.	A separate entity with the same rights and responsibilities as a person.
Business life	Business ends with owner death or choice.	Business ends with a partner death or choice.	Indefinite.	Indefinite.

*When a corporation issues only one class of stock, it is called **common stock** (or *capital stock*).

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Accounting Constraints

Cost-benefit constraint
Only information with benefits of disclosure greater than the cost need be disclosed.

Materiality constraint
Only information that would influence the decisions of a reasonable person need be disclosed.

Conservatism and **industry practices** are sometimes included as a constraint, also.

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Learning Objective A1

Define and interpret the accounting equation and each of its components.

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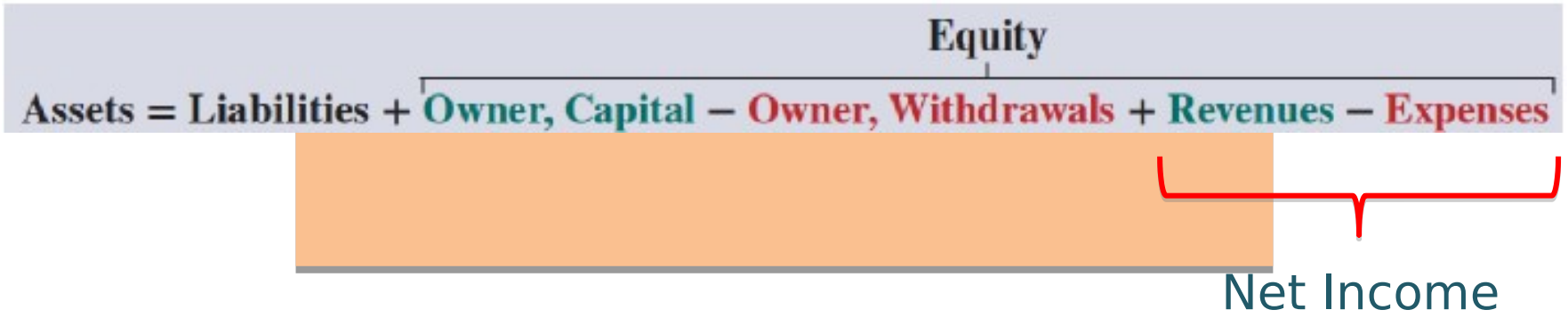
Business Transactions and Accounting

The Accounting Equation

Assets	=	Liabilities	+	Equity

Expanded Accounting Equation:



Learning Objective A1: Define and interpret the accounting equation and each of its components.

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Learning Objective P1

Analyze business transactions using the accounting equation.

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Transaction 1: Investment by Owner

Chas Taylor invests $30,000 cash in a new business named FastForward. FastForward is a proprietorship.

The accounts involved are:

1. Cash (asset)
2. C. Taylor, Capital (equity)

Learning Objective P1: Analyze business transactions using the accounting equation.

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Accounting Equation 1

Chas Taylor invests $30,000 cash to start the business, *FastForward*.

Assets				= Liabilities		+ Equity
Cash	Supplies	Equipment		Accounts Payable	Notes Payable	C. Taylor, Capital
(1) $ 30,000						$ 30,000
$ 30,000	$ –	$ –		$ –	$ –	$ 30,000
	$ 30,000		=		$ 30,000	

Learning Objective P1: Analyze business transactions using the accounting equation.

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Transaction 2: Purchase Supplies for Cash

FastFoward purchased supplies paying $2,500 cash.

The accounts involved are:

1. Cash (asset)
2. Supplies (asset)

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Accounting Equation 2

FastFoward purchased supplies paying $2,500 cash.

Assets			= Liabilities		+ Equity
Cash	Supplies	Equipment	Accounts Payable	Notes Payable	C. Taylor, Capital
(1) $ 30,000					$ 30,000
(2) (2,500)	$2,500				
$ 27,500	$ 2,500	$ –	$ –	$ –	$ 30,000
	$ 30,000	=		$ 30,000	

Accounting Equation must remain in

Learning Objective P1: Analyze business transactions using the accounting equation.

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Transaction 3: Purchase Equipment for Cash

FastForward purchased equipment for $26,000 cash.

The accounts involved are:

(1) Cash (asset)

(2) Equipment (asset)

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Accounting Equation 3

Purchased equipment for $26,000 cash.

Assets			= Liabilities		+ Equity
Cash	Supplies	Equipment	Accounts Payable	Notes Payable	C. Taylor, Capital
(1) $ 30,000					$ 30,000
(2) (2,500)	$ 2,500				
(3) (26,000)	$ 2,500	$ 26,000	$ –	$ –	$ 30,000
$ 1,500	$ 30,000				
		$ 30,000	=	$ 30,000	

Accounting Equation still remains in

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Transaction 4: Purchase Supplies on Credit

FastFoward purchased supplies of $7,100 on credit.

The accounts involved are:

(1) Supplies (asset)

(2) Accounts Payable (liability)

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Accounting Equation 4

FastForward purchased supplies of $7,100 on credit.

Assets			= Liabilities	+ Equity	
Cash	Supplies	Equipment	Accounts Payable	Notes Payable	C. Taylor, Capital
(1) $ 30,000					$ 30,000
(2) (2,500)	$ 2,500				
(3) $ 1,500	$ 9,600	$ 26,000	$ 7,100	$ –	$ 30,000
(4)	$ 37,100	=	$ 7,100	$ 37,100	

Accounting Equation still remains in

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Transaction 5: Provide Services for Cash

FastForward provided consulting services to a customer and received $4,200 cash immediately.

The accounts involved are:

(1) Cash (asset)

(2) Revenues (equity)

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Accounting Equation 5

FastForward provided consulting services to a customer and received $4,200 cash

Assets			= Liabilitie		+ Equity	
Cash	Supplies	Equipment	Accounts Payable	$ Notes Payable	C. Taylor, Capital	Revenue
Bal. $ 1,500	$ 9,600	$ 26,000	$ 7,100		$ 30,000	
(5) $ 4,200	$ 9,600	$ 26,000	$ 7,100	$ −	$ 30,000	$ 4,200
$ 5,700						
	$ 41,300		=		$ 41,300	

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Transactions 6 and 7: Payment of Expenses in Cash

FastForward paid rent of $1,000 and salaries of $700 to employees.

The accounts involved are:

(1) Cash (asset)

(2) Rent expense (equity)

(3) Salaries expense (equity)

Remember that the balance in the *Expense* accounts actually <u>increase</u>.
But, total Equity <u>decreases,</u> because expenses <u>reduce</u> equity.

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Accounting Equation 6 and 7

FastForward paid rent of $1,000 and salaries of $700 to employees.

Assets			= Liabilities		+ Equity		
Cash	Supplies	Equipment	Accounts Payable	Notes Payable	C. Taylor, Capital	Revenue	Expenses
Bal. $ 5,700	$ 9,600	$ 26,000	$7,100		$ 30,000	$ 4,200	
(6) (1,000)							(1,000)
$ 4,700	**$ 9,600**	**$ 26,000**	**$ 7,100**	**$ –**	**$ 30,000**	**$ 4,200**	**$ (1,700)**
(7) (700)							$ (700)
	$ 39,600	=		**$ 39,600**			

Remember that expenses decrease equity.

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Transaction 8: Provide Services and Facilities for Credit

FastForward provided consulting services of $1,600 and rents facilities for $300 to a customer for credit.

The accounts involved are:

(1) Accounts receivable (asset)

(2) Consulting revenue (equity)

(3) Rental revenue (equity)

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Accounting Equation 8

FastForward provided consulting services of $1,600 and rents facilities for $300 to a customer for credit.

Assets				= Liabilities	+ Equity		
Cash	Accounts Receivable	Supplies	Equipment	Accounts Payable	C. Taylor, Capital	Revenue	Expenses
Bal. $ 4,000		$ 9,600	$ 26,000	$7,100	$ 30,000	$ 4,200	(1,700)
$ (8) 4,000	$ 1,900 1,900	$9,600 $ 41,500	$ 26,000	$ 7,10	$ 30,000 $ 41,500	$ 6,100$ 1,600 300	$ (1,700)

Learning Objective P1: Analyze business transactions using the accounting equation.

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Transaction 9: Receipt of Cash from Accounts Receivable

Client in transaction 8 pays $1,900 for consulting services.

The accounts involved are:

(1) Cash (asset)

(2) Accounts receivable (asset)

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Accounting Equation 9

Client in transaction 8 pays $1,900 for consulting services.

Assets				= Liabilities	+ Equity		
Cash	Accounts Receivable	Supplies	Equipment	Accounts Payable	C. Taylor, Capital	Revenue	Expenses
Bal. $ 4,000	1,900	$ 9,600	$ 26,000	$7,100	$ 30,000	$ 4,200	(1,700)
(9) 5,900	0 (1,900)	$9,600	$ 26,000	$ 7,100	$ 30,000	$ 6,100	$ (1,700)
1,900		$ 41,500	=	$ 41,500		1,600	
						300	

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Transaction 10: Payment of Accounts Payable

FastForward pays $900 as partial payment for supplies purchased in transaction 4.

The accounts involved are:

(1) Cash (asset)

(2) Accounts payable (liability)

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Accounting Equation 10

FastForward pays $900 as partial payment for supplies purchased in transaction 4

Assets				= Liabilities	+ Equity		
Cash	Accounts Receivable	Supplies	Equipment	Accounts Payable	C. Taylor, Capital	Revenue	Expenses
Bal. $ 5,900	0	$ 9,600	$ 26,000	$7,100	$ 30,000	$ 4,200	(1,700)
$ (10,900)	0	$9,600	$ 26,000	$ (6,200)	$ 30,000	$ 6,100	$ (1,700)
						1,600	
						300	
	$ 40,600		=	$ 40,600			

Learning Objective P1: Analyze business transactions using the accounting equation.

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Transaction 11: Withdrawal of Cash by Owner

Owner withdraws $200 cash for personal use.

The accounts involved are:

(1) Cash (asset)

(2) C. Taylor, Withdrawals (equity)

Remember that the Withdrawals account actually increases (just like our Expense accounts).

But, total Equity decreases because withdrawals cause equity to go down!!

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Accounting Equation 11

Owner withdraws $200 cash for personal use.

Assets					= Liabilities	+ Equity			
Cash	Accounts Receivable	Supplies	Equipment	Accounts Payable	C. Taylor, Capital	C. Taylor, Withdrawals	Revenue	Expenses
Bal. $ 5,000	0	$ 9,600	$ 26,000	$6,200	$ 30,000		$ 4,200	(1,700)
11) (200)						(200)	$ 1,500	
$ 4,800	0	$9,600	$ 26,000	$ 6,200	$ 30,000	$ (200)	6,100	$ (1,700)
		$ 40,400			$ 40,400		300	

Learning Objective P1: Analyze business transactions using the accounting equation.

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Summary of Transactio

Exhibit 1.9

	Assets				= Liabiliti	+ Equity			
	Cash	+Accounts Receivable	+ Supplies	+ Equipment	= Accounts Payable	+ C. Taylor , Capital	+ C. Taylor , Withdrawals	+ Revenues	− Expenses
(1)	$30,000				=	$30,000			
(2)	− **2,500**		+ **$2,500**						
Bal.	27,500		+ 2,500		=	+ 30,000			
(3)	− **26,000**			+ **$ 26000**					
Bal.	1,500		+ 2,500	+ 26000	=	+ 30,000			
(4)			+ **7,100**		= **+$7,100**				
Bal.	1,500		+ 9,600	+ 26000	= 7,100	+ 30,000			
(5)	+ **4,200**							+ **$4,200**	
Bal.	5,700		+9,600	+ 26000	= 7,100	+ 30,000		+ 4,200	
(6)	− **1,000**								− **$1,000**
Bal.	4,700		+9,600	+ 26000	=7,100	+ 30,000		+ 4,200	− 1,000
(7)	− **700**								**− 700**
Bal.	4000		+ 9,600	+ 26,000	=7,100	+ 30,000		+ 4,200	−1,700
(8)		+ **$1,900**						**+ 1,600**	
								+ 300	
Bal.	4,000	+1,900	+ 9,600		= 7,100	+ 30,000		6,100	− 1,700
(9)	+ **1,900**	− **1,900**							
Bal.	5,900	0	9,600	+ 26,000	= 7,100	+ 30,000		+ 6,100	− 1,700
(10)	− **900**				**− 900**				
Bal.	5,000	0	9,600	+26,000	= 6,200	+ 30,000		+ 6,100	− 1,700
(11)	− **200**						− **$200**		

Learning Objective P2

Identify and prepare basic financial statements and explain how they interrelate.

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Financial Statements

Financial Statement	Layout	Purpose
Income statement	Revenues – Expenses Net income	Describes a company's revenues and expenses and computes net income or loss over a period of time.
Statement of owner's equity	Beg. capital + Owner investments + Net income – Withdrawals End. capital	Explains changes in owner's equity from owner investments, net income (or loss), and any withdrawals over a period of time.
Balance sheet	Assets = Liabilities + Equity	Describes a company's financial position (types and amounts of assets, liabilities, and equity) *at a point in time.*
Statement of cash flows	+/– Operating C.F. +/– Investing C.F. +/– Financing C.F. Change in cash	Identifies cash inflows (receipts) and cash outflows (payments) over a period of time.

Learning Objective P2: Identify and prepare basic financial statements and explain how they interrelate.

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Income Statement, Statement of Owner's Equity and Balance Sheet

FASTFORWARD
Income Statement
For Month Ended December 31, 2021

Revenues		
Consulting revenue ($4,200 + $1,600)	$ 5,800	
Rental revenue	300	
Total revenues		$ 6,100
Expenses		
Rent expense	1,000	
Salaries expense	700	
Total expenses		1,700
Net income		$ 4,400

FASTFORWARD
Statement of Owner's Equity
For Month Ended December 31, 2021

C. Taylor, Capital, December 1, 2021		$ 0
Plus: Investments by owner	$30,000	
Net income	4,400	34,400
		34,400
Less: Withdrawals by owner		200
C. Taylor, Capital, December 31, 2021		$34,200

FASTFORWARD
Balance Sheet
December 31, 2021

Assets		Liabilities	
Cash	$ 4,800	Accounts payable	$ 6,200
Supplies	9,600	Total liabilities	6,200
Equipment	26,000	**Equity**	
		C. Taylor, Capital	34,200
Total assets	$40,400	Total liabilities and equity	$ 40,400

Exhibit 1.10

Learning Objective P2: Identify and prepare basic financial statements and explain how they interrelate.

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Balance Sheet & Statement of Cash Flows

Exhibit 1.10

FASTFORWARD
Balance Sheet
December 31, 2021

Assets		Liabilities	
Cash	$ 4,800	Accounts payable	$ 6,200
Supplies	9,600	Total liabilities	6,200
Equipment	26,000	**Equity**	
		C. Taylor, Capital	34,200
Total assets	$40,400	Total liabilities and equity	$ 40,400

FASTFORWARD
Statement of Cash Flows
For Month Ended December 31, 2021

Cash flows from operating activities		
Cash received from clients ($4,200 + $1,900)	$ 6,100	
Cash paid for expenses ($2,500 + $900 + $1,000 + $700)	(5,100)	
Net cash provided by operating activities		$ 1,000
Cash flows from investing activities		
Cash paid for equipment	(26,000)	
Net cash used by investing activities		(26,000)
Cash flows from financing activities		
Cash investments by owner	30,000	
Cash withdrawals by owner	(200)	
Net cash provided by financing activities		29,800
Net increase in cash		$ 4,800
Cash balance, December 1, 2021		0
Cash balance, December 31, 2021		$ 4,800

③

Learning Objective P2: Identify and prepare basic financial statements and explain how they interrelate.

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Learning Objective A2

Compute and interpret return on assets.

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Return on Assets

Return on assets (ROA) is stated in ratio form as net income divided by the average total assets invested.

$$\text{Return on assets} = \frac{\text{Net income}}{\text{Average total assets}}$$

Exhibit 1.11

Return on Assets	Current Year	1 Year Ago	2 Year Ago
Nike	17.4%	8.4%	19.0%
Under Armour	2.0%	(1.1)%	(1.3)%

Exhibit 1.12

Learning Objective A2: Compute and interpret return on assets.

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End of Chapter 1

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